

PERFORMANCE AUDIT HIGHLIGHTS

August 1994

REGULATION AND TAXATION OF VACATION RENTALS AND NONCONFORMING LAND USES

Findings

Transient vacation units (TVUs) are typically condominium units located in apartment areas that are used for vacation rental purposes. Controversy began in 1993, when the City reclassified such properties for tax purposes from Apartment class to Hotel and Resort class. This meant a higher tax rate and a near tripling of property tax bills. Owners petitioned the City Council for relief. After receiving lengthy testimony, the Council found that an Administration proposal to accept a compromise payment of half the tax bill from TVU owners could not be legally authorized. Instead, the Council approved a tax refund and various amendments to tax and regulatory laws. The Council also directed the Office of Council Services (OCS) to conduct an audit of how the City identified, regulated, and taxed nonconforming uses, including TVUs (Resolution 93-351).

The Office of Council Services found that the City is inconsistent in how it regulates and taxes non-resort area vacation rentals. Such inconsistency is serious because it is unfair and can undermine the confidence of City taxpayers and residents in the system. First, although land, by law, is to be classified for tax purposes based on "highest and best use," classes have been created based on the actual use of the property. That means those properties are taxed at low rates, which shifts the tax burden to all other taxpayers. Second, TVUs and bed and breakfast facilities (B&Bs), which resemble other nonconforming vacation rentals, have been singled out for strict regulation, but in contradiction, have been provided special tax benefits. Third, there is no standard classification practice and therefore no consistent tax rate applied to vacation rentals or other nonconforming uses. Fourth, the lack of a single comprehensive regulation that applies to all visitor accommodations hampers their regulation.

OCS also found that the real property tax system is unbalanced. Because of the City's longstanding tendency to lower the tax burden for all homeowners, residential taxpayers have been paying an ever shrinking share of the tax burden at the expense of all other tax classes. The problem is compounded when low tax rates apparently stimulate efforts

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to legislate low rates for nonresidential property owners, such as owners of TVU properties.

It was found that the real property tax system is inconsistent with respect to some homes. For example, the property tax rate applicable to nonconforming homes (i.e. owner-occupied dwellings on nonresidentially zoned land) is widely divergent, meaning some homeowners are taxed at the lowest rates, others at the highest rates, serving no apparent public purpose.

Recommendations and Response

The Office of Council Services recommended that City land use and property tax policy affecting vacation rentals located outside of resort areas be made more consistent, comprehensive, and equitable. It further recommended that City policy on the assignment of property tax classes, and therefore tax rates, be reviewed to determine a more appropriate and consistent approach. If the highest and best use approach stated in existing ordinance is affirmed, the present system could be made more equitable by allowing differential tax rates to be applied to the land versus improvement components of the assessments of nonconforming uses only. OCS recommended the establishment of a homeowner tax class, limited to parcels used exclusively as the owner's primary residence, to more effectively address the tax burden of homeowners while maintaining consistent treatment of all other residential properties. It recommended an amendment to state law on business licensing to ensure all visitor accommodations were covered. Finally, OCS suggested that the restructuring of the City's database could better support its regulatory activities.

The Departments of Land Utilization (DLU) and Finance generally agreed with the recommendations made in the report. DLU took issue, however, with what it perceived was an implication that nonconforming hotels and time share units are not regulated. It also stated that restructuring its data collection and access systems was not necessary. Finance challenged the finding that some nonconforming hotels and time share properties are classified based on underlying zoning. It also disagreed that assessed land values of Waikiki parcels are inconsistent.

The Planning Department stated that nonconforming vacation rentals could be effectively eliminated by providing an amortization period, as discussed in the report.